

Appendix IV

Development Credit Authority and Alliances

USAID's Development Credit Authority (DCA) is a broad financing authority that allows USAID to use partial guarantees to encourage local private lenders/investors to finance development activities. The overriding goals of DCA are to mobilize private capital, leverage USAID funds, and demonstrate the economic viability of higher risk investments to the local banking sector and other sources of private capital.

While not all mission activities are suitable for credit financing, DCA lends itself to a range of sectoral activities. Completed deals to-date have been concentrated in the areas of energy and environment, infrastructure (including water), micro/small enterprise promotion, housing/mortgage, economic growth and agribusiness. DCA deals may include an institutional strengthening component for the financial sector partners as well.

Under the DCA, missions identify prospective alliance partners and design appropriate activities, based on their approved Strategic Objectives. USAID's Office of Development Credit helps in the design and development of cost estimates based on country risk factors approved by the USG Office of Management and Budget. USAID's Chief Financial Officer approves mission proposals for use of the credit authority. Missions pay for the cost of their DCA projects. The attractive feature is that these costs, which reflect the risk of default by the borrower, are shared equally by the private sector lender. Credit programs are highly leveraged: On average, DCA loan guarantees yield a 1:10 ratio of appropriated funds to actual development spending. More information on the DCA can be found at: www.usaid.gov/our_work/economic_growth_and_trade/development_credit

Examples

1. Loan Portfolio Guarantee

Mali: Agribusiness lending

Partial guarantees made available to BICIM bank will assist in mobilizing credit for medium and large-size agribusinesses operating in Mali and directly support the mission's ongoing activities in the agricultural sector. The DCA Guarantee will stimulate the growth of lending in the agricultural sector by demonstrating that lending to agribusinesses can be profitable, when risk is prudently managed. Technical assistance combined with a risk management tool, such as the DCA Guarantee, can be a powerful combination of resources serving to leverage private sector investment to achieve development goals.

Peru: Environmental compliance

This activity provides a local bank with a loan portfolio guarantee to provide capital for small and medium enterprises (SMEs) in Peru willing to introduce, upgrade or retrofit industrial processes that utilize cleaner technologies. End-of-pipe projects will also be eligible, provided that the corresponding projects could generate positive cash flows for the debtor, for instance, in avoiding pollution fines or penalties from the government, or in new sales generation to international clients requesting operative environmental standards. The activity will promote and support the development of sustainable financing mechanisms for cleaner production and directly contributes to the mission's ongoing environmental initiatives.

2. Loan Guarantee

South Africa: Low Income Home Loan Program

South African banks are reluctant to make new housing-related loans to lower income borrowers because of the potential default risks flowing from the HIV/AIDS pandemic. In order to promote continued lending by South African banks to low-income individuals seeking home-improvement or mortgage loans, the Home Loan Guaranty Company (HLGC) is entering into agreements with several South African banks and financial institutions to insure against the risk of defaults due to HIV/AIDS related incapacitation. USAID will share this risk with HLGC. The premium paid by participating banks for the HIV/AIDS related coverage, together with interest earned on it, will be used by HLGC to pay out claims. An estimated 600,000 households are expected to benefit from this program.

3. Bond Guarantee

India: Tamil Nadu Water and Sanitation Pooled Fund

Promoted under the Indo-USAID FIRE project, municipal bonds have been received enthusiastically by numerous municipal authorities in India. The bond guarantee will support the establishment of the "Water and Sanitation Pooled Fund" (WSPF), which will onlend to several municipal water and sanitation projects. The funds raised by the bond issue will be disbursed as sub-loans to the participating urban local bodies. The activity exemplifies the guiding principles of the DCA program by addressing current development objectives of USAID/India, correcting a market imperfection related to financing of urban infrastructure in the country, and showing financial viability in the project's debt repayment structure.

Kazakhstan: Mortgage Lending Market Development

The purpose of this activity is to support the development of mortgage lending and a secondary mortgage market in Kazakhstan by providing a 50 percent principal guarantee of a \$1 million three-year mortgage-backed bond issue by Lariba Bank, based in Almaty. Once the first bond is paid off, a new, four-year, \$1 million bond will be issued under similar terms. The pilot is designed to demonstrate that banks can originate mortgages and then liquefy them through the creation of a security and subsequent sale. This, in turn, gives banks the opportunity to re-lend and build a portfolio of mortgages for servicing while capturing a positive spread between the sale price of the note and weighted average coupon of the originated portfolio.